PENSION REFORM ACTION PLAN
City Manager's Department
May 2, 2011

This report to the League of California Cities Employee Relations and Revenue and Taxation Policy Committees and the Board of Directors is designed to address the League's 2011 Strategic Goal related to Pension Sustainability by providing information and recommendations that may be of assistance toward meeting the competing challenge of maintaining high-quality public services while providing fair and reasonable pensions for employees.

THE PROBLEM

Pension costs for many California municipalities continue to increase, threatening the delivery of basic public services, compromising general fund budgets, pushing some cities to the brink of fiscal collapse and indeed, posing a long-term fiscal challenge to the State itself. A former CalPERS actuary warned that by 2014 it will be common for local governments to budget 50% of police officer, 40% of fire fighter and 25% of miscellaneous employees' salaries for pensions; contributions that are fiscally unsustainable.

Causes of the problem include:

1. Enhanced benefit formulas granted after 1999 (SB400/AB616).
2. Reduced return on pension investments with the Great Recession.
3. Increased life span of retired employees.

A PRINCIPLED APPROACH

Public retirement systems should provide fair benefits for employees, and:

- Recognize the value of attracting and retaining high performing public employees to design and deliver vital public services to local communities.
- Recognize and support the value of a dependable, sustainable, employer provided Defined Benefits Plans (DBP) for long term employees; supplemented with other retirement options including personal savings (e.g. 457 Plan).
- Be portable across all public agencies in California.

STAGES OF A SOLUTION

Many steps below can, are, and should be taken locally and immediately, as part of the collective bargaining process to move local pension costs in a more sustainable direction. Further, as additional steps are taken to level the playing field for municipal agencies, State action is necessary to return the PERS (or other state-authorized pension systems) to a more sustainable framework. Many of the actions below are and will be presented to the State legislature for enactment and we believe the League of California Cities should engage the unions, Legislature, and Governor in the initiative process to formally change the structure of PERS thus protecting the fiscal integrity of cities and PERS retirement for public employees.

ACTIONS CITIES CAN AND ARE TAKING NOW AT THE COLLECTIVE BARGAINING TABLE TO REDUCE COSTS

- Have employees pay the employee's share of PERS costs: 8% for miscellaneous employees and 9% for safety employees.

- Provide a two-tier retirement system with new hires being placed in a reduced benefit tier.
- Have employees pick-up a portion of the employer's PERS costs.
- Base final retirement salary on the three highest years worked.
- Eliminate the PERS contract option of including Employer Paid Member Contribution (EPMC) in the calculation of an employee's base pay for retirement purposes.
- Restrict the calculation of an employee's retirement benefit to base pay only and do not allow base pay to include discretionary add-ons such as "specialty pays" or "longevity bonus pay" or the addition of accrued and unused sick leave or vacation time.

A City Manager Department survey in February 2011 indicates one in five cities responding to the survey have implemented a second tier for new hires.

ACTIONS NEEDED FROM THE STATE TO RESTORE THE SUSTAINABILITY OF PENSION PROGRAMS

Current constitutional law holds that current and former local government employees have rights to the pensions promised them at hiring. A Defined Benefit Plan is the most effective vehicle to accumulate and distribute pension benefits and is the preferred retirement system for municipal employees. The subsequent action items can be considered individually or in combination to improve the sustainability of PERS, thus, re-designing a system that will contribute to safeguarding public pensions. The following recommendations, with support from labor, would level the field on a statewide basis and lead to a maintainable PERS for public employees.

- Repeal SB400/AB616 returning to more sustainable PERS benefit formulas of 2% at 60 for miscellaneous employees and 2% at 55 for safety employees.
- Base final retirement salary on three highest paid years worked.
- Calculate benefits only on base salary eliminating all "spiking."
- Eliminate the purchase of "air time."
- Eliminate the availability of Employer Paid Member Contribution (EPMC).
- Require employees to pay the employees share of PERS (e.g. 8% for miscellaneous employees and 9% for safety employees.)
- Remove caps on the percentage employees can pay for the total cost of PERS programs.
- Give government agencies through the collective bargaining process the option to extend retirement ages for miscellaneous employees up to social security retirement ages.
- Prohibit retroactive pension increases.
- Meet any retirement needs for part-time employees with alternatives to a Defined Benefit Plan.
- Prohibit employees and employers from taking contribution "holidays."
- Change PERS vesting period to seven years.
- Provide employers with a hybrid pension system option that caps the Defined Benefit PERS pension at an annual maximum retiree benefit equal to 65% of the retiring employees' eligible base pay (determined by averaging the 3 highest year's pay) and supplement the DBP with a risk managed PERS defined contribution plan. According to staff of the National Institute of Retirement Security, dollar for dollar, a DBP yields considerably more retirement savings than a DCP. Therefore, a DCP should integrate with a DBP not, as some pension revision plans suggest, substitute for it.

- Have PERS provide more formula choices with lower benefit local options.

ADDITIONAL STEPS THAT APPEAR NECESSARY TO RESTORE PERS TO SUSTAINABILITY AND PROVIDE TRANSPARENCY

- Pension sustainability cannot be fully achieved without addressing the benefits of both current and future employees. After a detailed legal review and to the extent permitted by federal and state law, a well-designed State Constitutional Amendment is needed for prospective retirement formula reductions and incremental retirement age increases for current employees to guarantee their already accrued earned benefits, while making the plan sustainable, affordable and market competitive on a going-forward basis. The amendment should also include a risk-managed PERS Defined Contribution Plan for public agencies.
- The PERS Board needs to be restructured with a substantial increase in independent public members to insure greater representation of tax payer interests with regard to public pension decisions.
- Set uniform standards and definitions for disability benefits and evaluate the level of benefit that is considered as tax exempt. The tax exempt portion should either be eliminated or allowed on a proportional basis to the severity of the disability.
- Consider a standard public employee pension system where one benefit level is offered to every employee as a further option to restore sustainability to PERS.
- While not addressed in this paper, Other Post-Employment Benefits (OPEB), such as retiree health care, represents another unfunded liability for many local agencies and must be addressed through comprehensive reform measures.
- Develop a program with the State to ensure that pension programs offered by localities are fully transparent, and that the actuarial evaluation of unfunded components of OPEB's and Pension Plans are using standard investment return criteria.
- To the extent permitted by federal and state law prohibit payment of pension benefits to a public employees convicted of a felony related to fraudulently enhancing those benefits.

While pension reform is a primary fiscal challenge facing local agencies, it represents but one of several financial challenges that, when combined, represent a "Perfect Storm" that is leading to the insidious erosion of fiscal solvency of local governments. While some changes may take years, delay in dealing with the problem, only makes the situation worse!